MEMO

DATE: January 12, 2006

TO: The Transportation and Communications Committee

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SUBJECT: State Budget Update

SUMMARY:

On January 10, 2006, Governor Schwarzenegger unveiled his proposed $125.6 billion State Budget for 2006-07. The Budget calls for increased funding for Education, Transportation, and Healthcare programs for low-income children, while reducing expenditures generally for welfare and welfare-to-work programs, and supplemental security income payments to disabled persons. There are no tax increases.

The Budget proposes to spend $97.9 billion against $91.5 billion in anticipated revenues for the fiscal year. The resulting $6.4 billion deficit is expected to be paid for by carrying over a surplus from the current budget year due to an increase in revenues from an improved economy. Thus, the Budget does not address inherent structural deficiencies and projects a $6.6 billion shortfall in 2007-08.

Because there are carry-over funds from the current budget year and because state revenues are up from many sectors over last year, the Governor proposes several spending enhancements for transit and transportation, as detailed below.

BACKGROUND:

Full Funding for Proposition 42

The '06-07 Budget proposes full funding of Proposition 42 which will transfer a total of $1.4 billion from the General Fund (GF) to transportation programs, including transit and highway projects and services. The transfer will be distributed as follows:

- $678 million to the Traffic Congestion Relief Program (TCRP) projects;
- $582 million to the State Transportation Improvement Program (STIP), and;
- $146 million to the Public Transportation Account.

Total: $1.406 billion

Additionally, the Budget proposes an early repayment of a portion of the 2004-05 Proposition 42 loan (currently due to be repaid in '07-'08) in the amount of $920 million. These dollars will be allocated as follows:

- $410 million to the Traffic Congestion Relief Fund (TCRF) for TCRP projects;
- $255 million to the STIP;

Prop. 42 (Cont.)

- $255 million to cities and counties for local streets and roads.

Total: $920 million

This early repayment combined with the full funding of the base transfer will provide an additional $2.3 billion for transportation in 2006-07.

Total: $2.3 billion

Finally, the Governor proposes a Constitutional Amendment to "firewall" Proposition 42 by eliminating the current ability of the Governor and Legislature to suspend Prop. 42 and, thus, protect these funds for their intended uses in transportation.

Indian Gaming Bonds

The 2005 Budget Act assumed repayment of a portion of outstanding transportation loans with $1 billion in bond proceeds derived from certain Indian Gaming Revenues to specified transportation programs. Subsequent litigation has delayed the issuance of the bonds; nevertheless, the Budget assumes the bond sale will occur in the spring of 2006. As the legal issues are evaluated, the sale date may be adjusted but, when it occurs, the revenues will be allocated as follows:

- $465 million to the State Highway Account;
- $290 million to the TCRP;
- $122 million to the Public Transportation Account;
- $122 million to cities and counties on a formula basis for local streets and roads purposes.

Total: $1 Billion

Federal Transportation Reauthorization

The Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) was enacted August 10, 2005, and authorizes Federal surface transportation programs for highways, highway safety, and transit for the five-year period of 2005-2009. The Budget includes approximately $2 billion in 2005-07 due to the increased apportionments included in SAFETEA-LU.

Total: $2 billion

Traditional State Transportation Revenues

The Budget forecasts gas and diesel excise tax revenues to increase by approximately 2.4% in 2006-07 from $3.4 billion to $3.5 billion. Funds are distributed to the State Highway Account and the cities and counties for transportation purposes.

Total: $3.5 billion

Public Transportation Account (PTA)

The Budget proposes to suspend spillover revenues to the Public Transportation Account. Specifically, it retains the first $200 million of spillover in the General Fund, and directs the next $125 million to go to the Bay Bridge seismic retrofit project, for a total suspension of $325 million.

Caltrans/Capital Outlay

The Budget proposes $11.5 billion for the Department of Transportation, of which 9.2 billion is from non-General Fund sources. Of these amounts, $4.8 billion is proposed for transportation capital outlay programs comprised of $2.3 billion from the General Fund, $1.2 billion from the State Highway Account, $1.1 billion in federal funds, and $90 million from other special funds.

The budget proposes capital outlays in the follow areas:

- 2006 State Transportation Improvement Program (STIP) Fund Estimate covers a 5 year period from 2006-07 through 2010-11, and assumes a total programming capacity of approximately $5.6 billion, of which $3.8 billion is carried over from the 2004 STIP. The 2006 STIP adds $1.8 billion in new programming capacity;

- State Highway Operation and Protection Program (SHOPP) is comprised of projects that reduce collisions and hazards to motorists, preserve bridges and roadways, enhance and protect roadsides, and improve operation of the state highway system. The 2006 Fund Estimate assumes $12.9 billion in SHOPP funding from 2006-07 through 2010-11. For 2006-07, $1.7 billion is included in the Budget.

Local Assistance Programs

The Budget proposes $3.3 billion in local assistance funding for transportation in 2006-07, for use for local capital improvement projects on the state highway system, mass transit capital improvement projects, and local bridge improvement projects. This appropriation includes $978 million for local mass transportation projects. The total is comprised of $191 million from the State Highway Account, $1.8 billion in federal funds, and $1.3 billion from other special funds. The assistance to transit agencies in the State Transportation Assistance Program for operations in 2006-07 is $ 235 million.

Strategic Growth Plan

Concurrent with the 2006-07 proposed Budget, the Governor has announced The Strategic Growth Plan (SGP), which outlines the first 10 years of a 20 year investment in all sectors of the economy and public services. The plan seeks to implement $222 billion in infrastructure investments, of which $107 billion is targeted for state system transportation purposes over the next 10 years. $68 billion of the total infrastructure investment will be financed with General Obligation (GO) bonds through a series of elections in two year increments from 2006 through 2014. The transportation portion of the $68 billion GO revenues is $12 billion, which will be put before the voters in two $6 billion increments on the June 2006 and November 2008 ballots.

The first of these bond proposals, if approved, would provide funding from 2006-07 through 2010-11, would appropriate funds as follows:

- $1.7 billion to increase highway capacity;
- $1.3 billion for safety and preservation improvements to the state highway system;
- $1 billion for port improvements, mitigation related to programs and projects that reduce diesel emissions, and mitigation of other community impacts;
- $1 billion for goods movement infrastructure;
- $400 million for intercity rail expansion;
- $300 million for corridor mobility improvements;
- $200 million for Intelligent Transportation Systems;
- $100 million to expand park and ride and bicycle/pedestrian improvements.

The second bond proposal, if approved, would provide funding from 2011-12 through 2016-17, and would appropriate funds as follows:

- $3.6 billion for highway projects providing congestion relief and meet or exceed performance measures for improved corridor performance;
- $2 billion for goods movement infrastructure;
- $200 million for highway safety and preservation projects;
- $100 million for additional intercity rail expansion
- $100 million to expand park and ride and bicycle/pedestrian improvements.

The SGP contains a proposal to seek a Constitutional Amendment to prohibit the Legislature and the Governor from incurring General Fund-supported debt if the debt service on that debt plus the debt service on outstanding General Fund-supported debt, including the GO Bond debt incurred pursuant to the SGP, is expected to exceed 6% of the General Fund revenues in any given year for five years into the future. Additionally, the Governor's proposal contains yearly estimates of the SGP Financing Debt Ratio from the current year through the year 2025-26 which range from 3.81% to 5.91% of General Fund Revenue in any given year.

Finally, passage of the GO bonds would be tied to enactment of design sequencing, design build and public private partnership legislation.

Summary

This budget is generally good for Transportation because it provides for increased funding overall and specifically earmarks existing surpluses to fully fund Proposition 42 and to provide for the early repayment of the Prop. 42 loan. However, there remain important questions for the future pertaining to assumptions made by the Governor's Budget regarding the size and scope and likelihood of voter approval of successive bond measures to finance further infrastructure development; the time frame for moving forward with an issuance of Indian Gaming Bonds; and the likelihood of getting a Constitutional Amendment on the ballot in the near future to protect Prop. 42 funds.

Likewise, according to the Legislative Analyst's Office, there are key issues that the Legislature will face as it reviews the Governor's budget proposal and proceeds to craft its own budget plan:

- The Legislature must carefully weigh the benefits of the proposed expansion programs against the potential continued out-year deficits and seek opportunities to address the underlying structural imbalance;

- The Legislature must determine if the proposed program expansions reflect its own budgetary priorities, and whether they represent an effective and efficient use of taxpayer resources;

- Although the proposed budget uses some of the recent revenue improvement to reduce budgetary debt accumulated in past years, there still remains considerable debt, such as in the area of unfunded mandates. This will pose a burden for future budgets if not addressed now.

- Although the budget is based upon reasonable assumptions about the economy and revenues, there are risks of economic downturn such as rises in interest rates, contraction of the housing market, a faltering of the stock market, etc., which would cause a significant drop in economic growth and revenue performance. The Legislature may wish to use extra caution in undertaking new, ongoing program commitments given such uncertainties.

All of these issues will come in to play in 2006 as the budget makes its way through the process and will be closely monitored by SCAG for input and action.